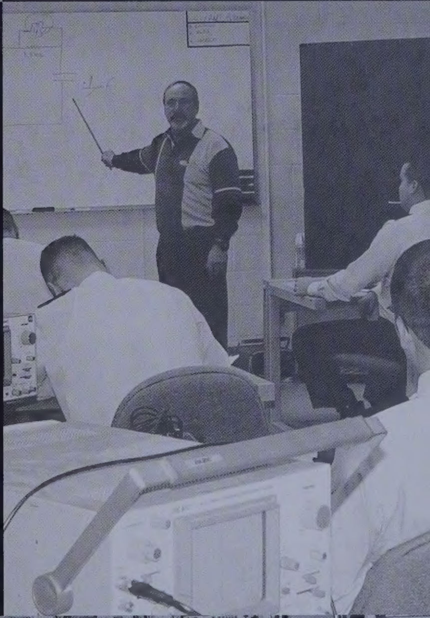
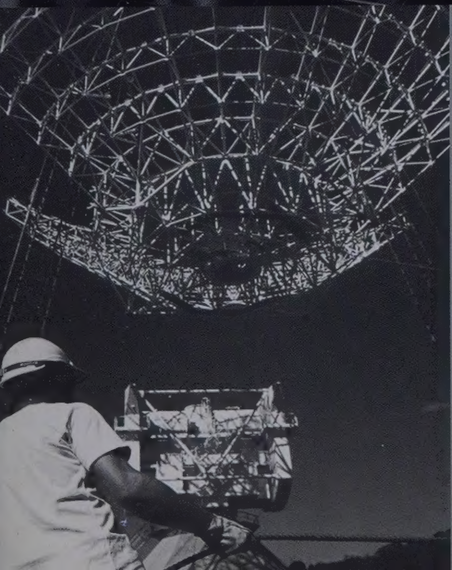
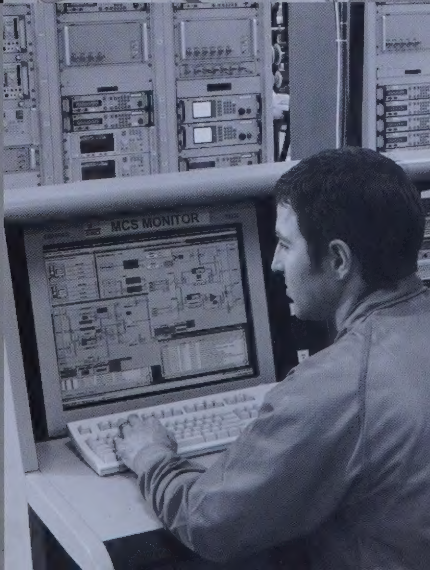
Calian 2003 Annual Report







CALIAN

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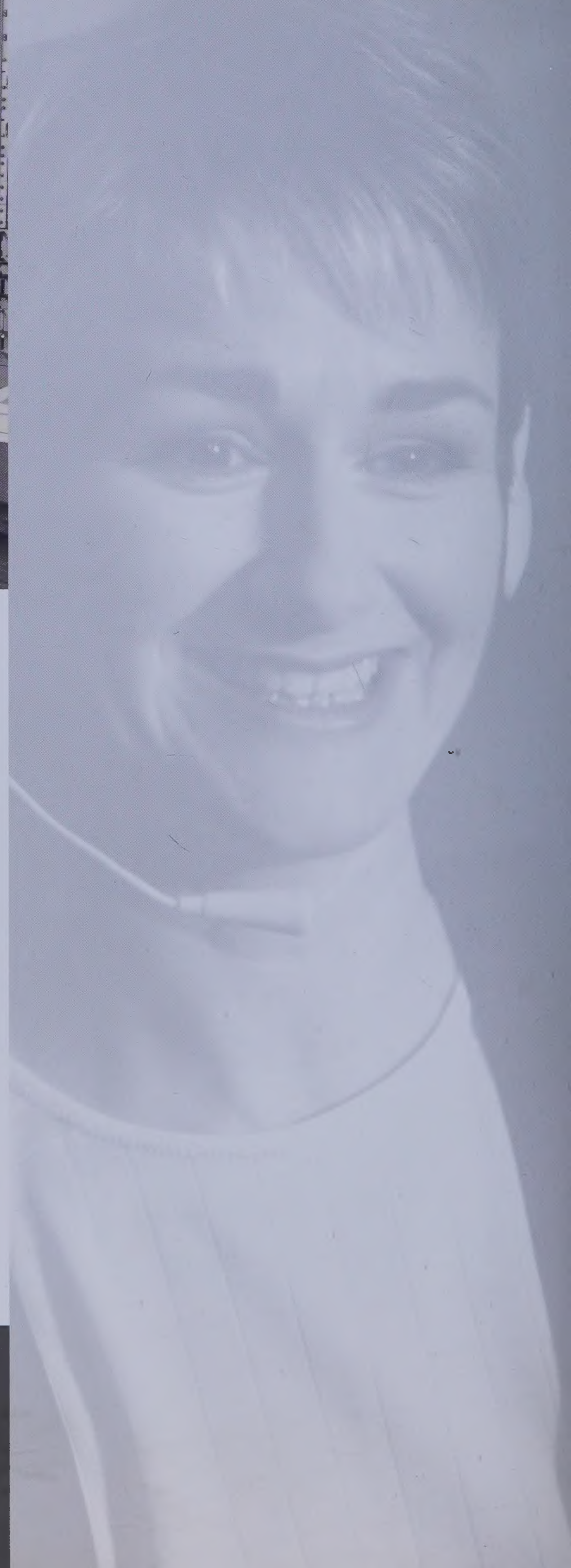
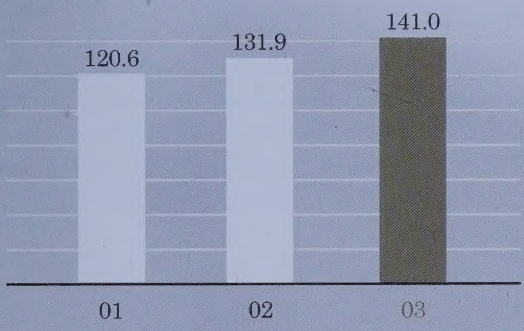
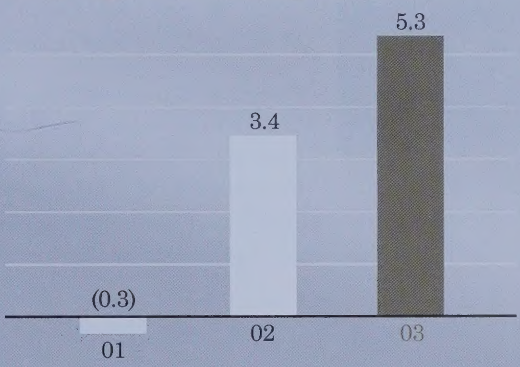


(millions of dollars except per share data)

Revenues

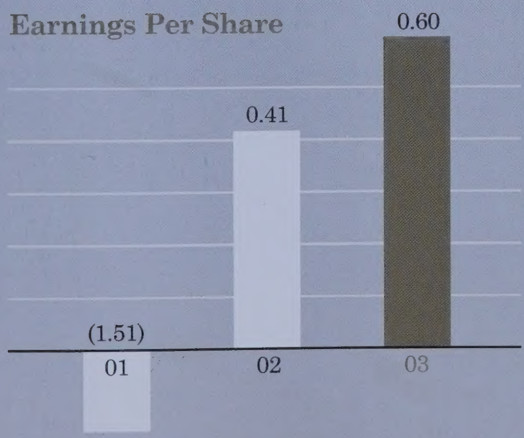


Earnings, Continuing Operations

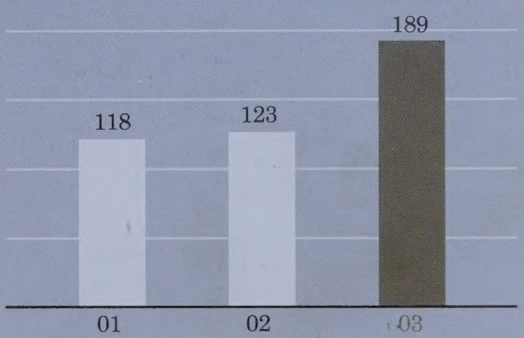


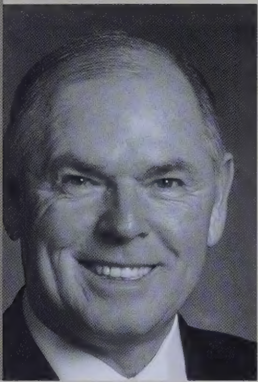
Stock Price compared to TSX

Earnings Per Share



Backlog





Message from the Chairman and CEO

In all respects, 2003 was a solid year of execution and performance for Calian. Both our Systems and our Services divisions established new highs in operational performance. As a result of the management team's talent, our stock price has been performance driven and increased 133% over the prior year from $3.81 to $8.88.

Our gain in net worth during 2003 was $3.0 million, which increased our book value by 10% to $3.53 per share. Over the past two years since we restructured and returned to our core business of selling technology services to industry and government, our book value per share has grown at a compounded annual rate of 12%. This was accomplished while at the same time paying dividends and repurchasing shares. Better yet, our backlog has grown this year by over 50% to $189 million, which bodes well for continued profitable growth.

A Strong Management Team

I would like to commend the entire team, led by Ray Basler, our President and COO, for their exceptional strength and courage. I have been asked many times how we were able to regroup so quickly from our loss in 2001. The answer was pretty simple really—our company is blessed with an exceptional management team that wins often and does so in a quiet, confident manner. As a result of their work, Calian was able to outstrip the S&P/TSX index by a factor of five this year, truly an astounding accomplishment. I look forward now and a confluence of favorable factors has given me great cause for optimism for the future.

The "Long Boom" Continues

Industry and government continue to adopt technology at a relentless rate. Both our Systems and Services divisions are active in helping our clients apply and use technology in a cost effective and efficient manner. We are assisting on projects ranging from the development of deep space communication antennas for the European Space Agency to helping the Department of National Defence use computer technology to simulate war games and help train officers to make battlefield decisions. The scope of our activities is wide and today we are helping our clients adopt and use technology on over 100 different projects. This constant adoption of technology is a fundamental driver of our business.

There are two other factors that define our competitive advantage. First, our low cost structure enables us to be very competitive in our pricing while still providing a healthy return to our shareholders. Second, our strategy is to focus our marketing on specialized niches where we can create barriers to entry for those that may wish to compete with us. These two factors coupled with the general growth in the use of technology around the world will provide Calian with substantial growth opportunities for years to come.

On Corporate Governance

We have attempted to stay on the leading edge of the governance issue well before this became a hot topic.

In 2002 we made sure our Audit Committee was 100% composed of independent Directors. At the same time the Board decided to cancel our share option plan and replace it with a bonus program that connected the dots between the bonus and the annual dividend payout—the more cash we have for bonus payout, the more cash we have for dividends. This approach has resonated with our management and with the investment community as being both fair and reasonable.

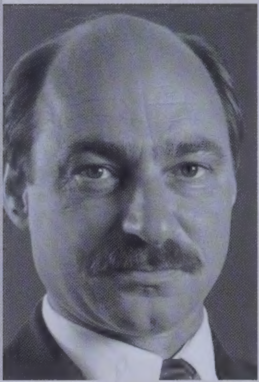
And in 2003, we addressed the call for the separation of duties of the CEO and the Board. In order to achieve separation, we appointed a Lead Director and we now have a fixed Board agenda that provides our Board a quarterly opportunity to meet without the presence of the Chairman and CEO. We have a wise, experienced and independent Board and I am confident that we have built a solid foundation of governance for the Company that will last well into the future.

The Annual Meeting

The annual meeting of shareholders will be held at the Brookstreet Hotel in Kanata, Ontario on January 27, 2004 at 3:00 p.m. Many of our Board members and all of our senior management team will be available to answer your questions and I hope that you can join us for an informal reception after the meeting.

Larry O'Brien

Chairman and CEO



Report on Operations

2003 was another record year for Calian. Our focus on execution and delivery has resulted in increased revenues and improved margins. When coupled with our keen attention to operating costs and efficiencies, it has yielded record profitability.

Once again, both the Systems and the Services divisions have capably executed against their plans and each has contributed significantly to the overall results. Our excellent short-term performance has not been at the expense of the longer term. Our business development strategies have yielded a backlog of $189 million, healthy in absolute numbers as well as profit potential.

We have strong and experienced management teams that have created a business environment that fulfils the expectations of both our customers and our employees, while at the same time providing a respectable return to our shareholders. Most importantly, we are committed to building the depth required for long-term success.

Systems Engineering

The Systems Engineering Division (SED) has once again achieved top results. Revenues increased by 9% over the prior year, a significant achievement considering the prolonged slowdown in the satellite industry. The quality of our products and the ultimate satisfaction of our customers continue to be the key tenets of our business. With our focus on project execution and the efficient application of our labour resources, we have achieved a 30% increase in operating contribution.

Our reputation for timely delivery of quality systems has brought repeat business from existing customers and attracted new ones as well. Inmarsat once again provided an excellent source of work as they continued with the rollout of their next generation of satellites and implemented new systems that provide efficient management of all of their valuable satellite resources. Our exceptional performance on the European Space Agency's first deep space antenna convinced them to contract with SED for a second antenna amid steep European competition. This $33 million contract will extend well into 2005.

Likewise, our past performance on high quality custom manufacturing contracts has resulted in new orders from Systems and Electronics Inc. and Kidde Dual Spectrum for products destined for the defence and security markets. This recurring source of work has been instrumental in achieving operational efficiencies in our manufacturing group.

In order to further enhance our opportunities for growth, we will endeavour to apply our capabilities to adjacent markets by utilizing our core competencies. Our key objectives are to expand our customer base and to concentrate on opportunities with a recurring flow of work. In addition to providing growth opportunities, these strategies will also serve to ease the inevitable peaks and valleys associated with the project business and the markets we serve.

Business and Technology Services

The Business and Technology Services Division also had an excellent year with revenue growth of 6%. Having achieved stability in the business, the key objectives were to focus on improving margins and achieving further back office efficiencies. We were successful on both counts and achieved an impressive 85% increase in divisional operating contribution for the year.

Our focus on business delivery has yielded an almost perfect record in terms of contract renewals. The Canadian Department of National Defence continues to be a major customer and the $60 million multi-year renewal contract for academic research assistance to the Royal Military College is testimony to the high quality of our services. In addition, our ability to assemble qualified and cost effective teams to meet our customers' technology needs has resulted in new contracts for training at the Canadian Forces School of Communications and Electronics as well as the provision of professional services to the Canadian Forces Joint Support Group. Our US-based Content Management Services (CMS) group continues to exploit their technology proficiency in the application of high-end content management systems and technical services. With extensive expertise in North American and European defence-oriented projects, our CMS team continues to gain momentum. New contracts with major aerospace companies have allowed the CMS group to apply this expertise on the F-117, U-2, F-16, C-130 and Global Hawk programs.

Even in the midst of a difficult economic setting, we have been able to maintain our level of private sector business. We believe that we are well positioned for growth when our commercial customers react to a sustainable recovery.

Underlying our success is our unwavering commitment to quality. We have recently achieved Level 2 accreditation from the National Quality Institute, further evidence that our systems and business delivery processes are best-of-breed and well engrained in our operating philosophies.

With a healthy backlog and an efficient back office, we are well positioned for the future. Our strategy of broadening our customer base, coupled with the benefits of economies of scale, are expected to yield growth in revenue as well as operating returns.

After having achieved impressive reductions in corporate and common costs in the prior year, we are pleased with our ability to control them, particularly in light of the ever-increasing administrative demands placed on public companies. We expect to continue our philosophy of autonomous divisional operations supported by a lean corporate office.

2003 represents a continuation of the improvements we had initiated in the prior year. Effective project execution and improved business delivery practices have resulted in tremendous strides in improving profitability. With a significant backlog, strong management, and the availability of human and financial resources, we are well positioned to achieve growth and enhance profitability.

R Basler

Ray Basler

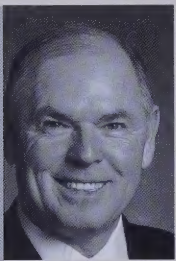
President and COO

Business of the Company

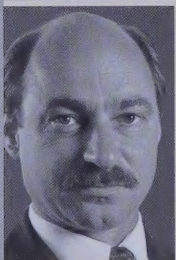
Calian sells technology services to industry and government.

Founded in 1982, Calian has emerged as a leader in the technology services industry. Our customers are many and varied, and include organizations in both the public and private sectors. With annual revenues of $141 million and a staff of over 2,200, Calian ranks among largest professional services companies in Canada with 56 Ph.D.s, 120 Masters and 305 Bachelors.

Senior Management Team

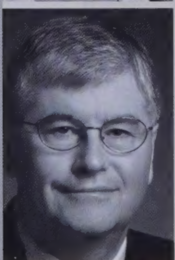


Larry O'Brien
Chairman and CEO



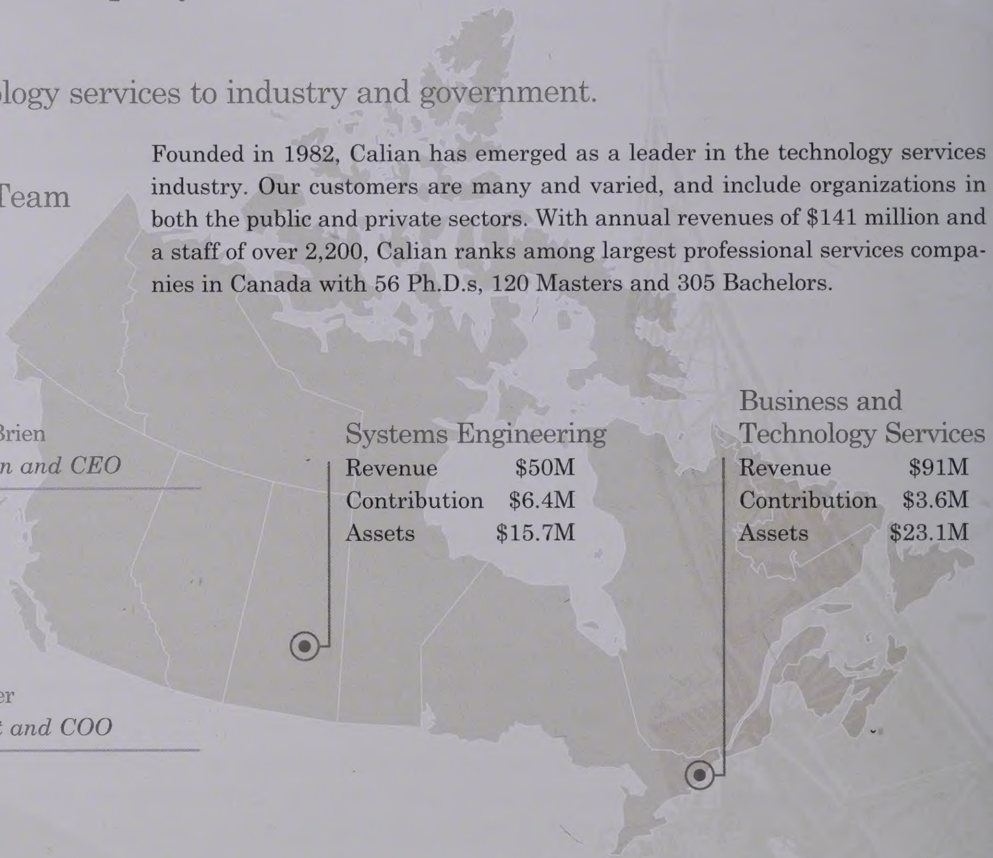
Ray Basler
President and COO

Jacqueline Gauthier
VP, CFO and Corporate Secretary

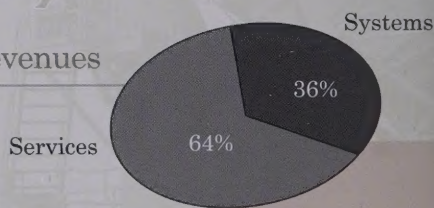


Tom Coates
VP and General Manager,
Business and Technology Services

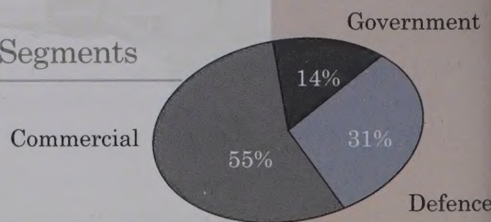
Brent McConnell
VP and General Manager,
Systems Engineering



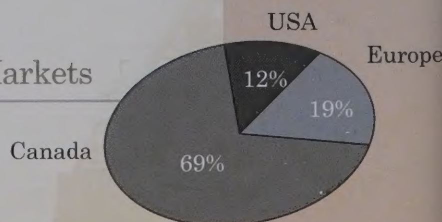
Divisional Revenues



Customer Segments



Geographic Markets



Systems Engineering

We design, implement and install systems for the communication industry; systems needed to connect users, manage traffic, verify system performance and enhance network throughput and efficiency. Our primary market is the satellite communications sector. Customers include many of the world's leading satellite manufacturers, operators and service providers. More than 75% of our annual revenues are derived from exports.

Our approach is simple. Based on individual needs, we evaluate and select advanced commercial equipment from reliable suppliers and integrate it into systems tailored to meet specific requirements. This means less development, lower risk and cost, and faster delivery.

Our customers can delegate the development of the large and complex systems they need, confident that our technical and management skills will deliver what we promised, when we promised it, and at the agreed price. Our core competencies differentiate us from our competitors—strong project management, systems engineering know-how, and software development. Our full-service approach addresses needs from design through long-term maintenance, helping our customers roll out new services on time and to manage them profitably.

Our approach has been successful. Our systems are deployed worldwide and are now operating on six continents. Our customer base includes industry leaders in the global communication market. Many of these have been our customers for more than 10 years and we routinely enjoy their repeat business.

First of two 35-metre antenna systems for the European Space Agency.

A variety of systems for Inmarsat's new broadband satellite program.

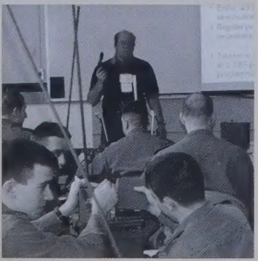
Business and Technology Services

We help our customers manage their changing workforce requirements by providing ready access to an exceptional team of engineers, telecommunications and technology professionals, administrative and other highly qualified business staff.

Our primary customers are Federal Government departments and large national and multi-national companies in the communications, defence, aerospace and manufacturing sectors, with 7% of revenues derived from the US. We augment customer workforces by providing flexible short and long-term contract staff, recruitment services and multi-year outsourcing activities including project management, technical operations, training and engineering support functions.

Our services allow customers to focus their vital internal resources on key priorities. Our value includes the breadth of services we offer, exceptional recruiting capabilities for skills that match our customers' needs, effective management of our employees in the field, and competitive rates. By taking the time to understand customer requirements and then delivering what each client needs, both Calian and its customers achieve their business goals.

Operations and maintenance services for the Canada Centre for Remote Sensing.



Training in electronics and signal operations for National Defence personnel.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management Discussion and Analysis should be read in conjunction with the audited consolidated financial statements and notes included in this annual report. As in the consolidated financial statements, all dollar amounts in this Management Discussion and Analysis are expressed in thousands of Canadian dollars unless otherwise noted.

Overview

Industry and government have been adopting new technologies for many decades and management expects that they will continue to do so in the forseeable future. This trend is not expected to change as customers continue to look for better and more efficient ways of operating their businesses. In order to address these markets, Calian has built a unique combination of specialized internal capabilities coupled with a large reservoir of externally available talent. These resources provide Calian with the ability to promptly assist customers implement their diverse technology needs through the timely assembly and deployment of teams of professionals with the requisite capabilities. Whether it is the design and integration of a complex satellite ground system or the provision of specialized training and operations, Calian is able to deliver its service in a timely and reliable manner that is not always achievable by its larger mainstream competitors. Calian experiences repeat business and a large number of contract renewals due in part to the Company's successful delivery and execution of projects. With efficient and flexible operating processes, we have been able to profitably address lower margin business without compromising quality or performance, thereby further distinguishing the Company from its competitors.

Calian delivers its services through its wholly owned operating subsidiaries Calian Ltd., Calian Inc. and Calian Technology (US) Ltd. Calian currently operates in two reportable segments, defined by their primary type of service offerings:

> Systems Engineering involves planning, designing and implementing solutions that meet a customer's specific business and technical needs, primarily in the satellite communications sector. The Systems Engineering Division has its principal office in Saskatchewan.
>
> Business and Technology Services involves both short and long-term placements of personnel to augment customers' workforces (Staffing) as well as the long-term management of projects, facilities and customer business processes (Outsourcing). The Business and Technology Services Division has its principal Canadian offices in the Ottawa area and its US office in Virginia.

For the current year ended September 30, 2003, the Company's main goal was to build upon those activities that the Company does best. Both business segments planned to achieve their revenue targets through strategically focused business development activities and doing so with minimal increase in administrative costs. All of these objectives were met, thereby delivering solid profitability and cash flow.

Earnings before interest, income taxes and amortization of goodwill increased to $8,418 in 2003 compared with $5,595 in 2002. The Company reported net earnings of $4,848 for the year compared with $3,419 in the previous year.

At September 30, 2003 there was $25,185 of cash and equivalents on the balance sheet. The elements that make up the foregoing measures of profitability and cash flow are discussed below.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

Revenues

Total revenues for the year ended September 30, 2003 were $141,040, a 7% increase over 2002 revenues of $131,876. The general business environment in 2003 was very competitive; however, Calian's ability to deliver high quality service, coupled with its strong customer relationships and successful business development efforts have resulted in moderate revenue growth.

Calian's Systems Engineering Division accounted for revenues of $50,398 or 36% of total revenues, while the Business and Technology Services Division accounted for the balance of $90,642 or 64% of revenues. A year earlier, Calian's Systems Engineering Division generated revenues of $46,373 or 35% of the total, while the Business and Technology Services Division accounted for $85,503 or 65% of total revenues.

During the year, the Company was successful in winning new business and in securing a number of large contract renewals:

> A $33 million contract was awarded by the European Space Agency (ESA) to the Systems Engineering Division to provide a 35-metre antenna system in Europe to support ESA's deep space missions. The project will be completed over a 30-month period and is scheduled for delivery in late 2005. This is the Company's second deep space antenna project with ESA; Calian was also the prime contractor for the first system, which was recently commissioned in Australia.
>
> A $60 million renewal was awarded to the Business and Technology Services Division for the provision of academic research assistance to the Royal Military College of Canada (RMC) in Kingston. This is a continuation of the services Calian has been providing in support of RMC since 1997 and extends over a period of six years. Calian will provide technical and professional personnel to carry out research activities at RMC in science, engineering and humanities in the area of counter-terrorism.

These large contract wins combined with many smaller successes resulted in the Company completing the year with a record backlog of $189 million; 39% of this backlog is expected to be earned as revenue in 2004, 25% in 2005 and 36% thereafter.

The revenues of the Systems Engineering Division increased by 9% over the prior year. The revenues of this division can vary significantly from one year to the next depending on the realized mix of labour versus non-labour components. The success of 2003 is partly a result of a higher labour mix but also a result of the ability to continue winning new business with key long-term customers despite the downturn in the satellite industry. A good example was the division's ability to stand out from other competitors when bidding for the second ESA antenna because of the reputation it built with ESA when providing the first system. With this contract in hand, the Systems Engineering Division begins 2004 with a backlog of $68 million of which approximately 54% is expected to be earned in 2004.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Revenues in the Business and Technology Services Division increased by 6% over 2002 levels. This increase is attributed to increased demand for services with existing public sector customers combined with revenues generated from new contract wins late in 2002. Delays in the funding of new Federal Government programs and increased delays in the procurement cycle of the Federal Government have created a very competitive marketplace. The long-term nature of a significant portion of the division's business and its reputation for delivering quality services helped the division succeed despite such marketplace barriers and achieve moderate growth. Despite the competitive marketplace, the Business and Technology Services Division was successful in securing substantially all of its long-term contracts up for renewal in 2003 and will begin 2004 with a near record backlog of $121 million of which 30% is expected to be earned in 2004.

The Company derives a significant portion of its revenues from the Government of Canada. During the year, 38% of revenues were related to contracts with various departments and agencies of the Government of Canada, compared to 37% in 2002. Both of the Company's divisions conduct business with this major customer.

The Company also derived 21% of its revenues from a major customer in the call center business compared with 22% in 2002.

Management expects the marketplace in 2004 to be similar to the one experienced in 2003. Aside from positive indicators in the security and surveillance market, management expects moderate revenue growth in 2004.

Cost of revenues and Gross profit

The Company's cost of revenues includes all direct costs incurred in the provision of its products and services. These costs include all expenses associated with direct full-time staff, contract staff and subcontractors. They also include other direct costs, including the landed cost of hardware and software sold as components of a solution, travel and living expenses necessary in the delivery of the services, and provision for warranty where applicable.

For the year ended September 30, 2003, the Company reported a gross profit of $25,386 or 18.0% of revenues, which compares to $22,819 or 17.3% a year earlier. Gross margins can vary significantly from year to year depending on the overall sales mix of the Company's services and the level of non-labour flow-through on projects.

Gross margin was 23.3% in the Systems Engineering Division during 2003 compared to 22.0% the previous year. This was a result of a higher labour component in revenues, which generally attracts higher margins, along with exceptional labour utilization rates and excellent project control.

In the Business and Technology Services Division, the gross margin was 15.0% in 2003 compared with 14.8% in 2002. This slight increase is primarily due to the growth in higher margin projects.

The prolonged downturn in some of the Company's markets and the uncertainty regarding Federal Government spending will continue to produce a very competitive marketplace, which in turn will put significant pressure on gross margins. However, with a healthy backlog and efficient execution of projects, management's objective is to maintain margins at existing levels.

Selling, administration and other expenses

The Company separately identifies four principal expense categories in its consolidated financial statements—selling and marketing, general and administration, facilities, and amortization of capital assets. These are referred to in the Management Discussion and Analysis as selling, administration and other expenses.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Selling, administration and other expenses totaled $16,968 or 12% of revenues in 2003. This compares to $17,224 or 13% of revenues in 2002. As described below, the overall decrease of expenses as a percentage of sales is a direct result of the Company's efforts in controlling its overhead costs. Management believes that, for the foreseeable future, operating costs should not increase proportionately to sales growth.

Selling and marketing

Selling and marketing expenses reflect all direct selling costs including salaries, commissions, travel and living expenses, the costs of proposal development and submission, and the costs of account management activities conducted by sales personnel. The costs of the recruiting department are also classified as selling and marketing expenses, as this sales support role is key in obtaining resources for customers.

Selling and marketing expenses totaled $4,409 compared to 2002 when they were $4,601. Selling and marketing expenses as a percentage of revenues were 3.1% in 2003 compared to 3.5% in 2002. This decrease was noticeable in both divisions. Selling and marketing expenses are expected to increase slightly over the 2003 level as the Company will focus its efforts towards broadening its customer base and expanding its service offering to new markets. However, selling and marketing expenses are not expected to increase proportionately to the growth in sales as the Company continues to focus on controlling costs.

General and administration

The Company's general and administration expenses include all overhead-related expenses except facilities. General and administration expenses were $8,574 in 2003, compared with $8,330 the previous year. The increase is mainly attributable to increased incentives, a direct result of increased profitability. All other expenditures remain stable as a result of the Company's continuous cost control activities. As a result, general and administration expenses as a percentage of revenues decreased to 6.1% in 2003 compared to 6.3% in 2002. Management believes that the Company can deliver an increased level of business without significantly affecting general and administration costs.

Facilities

Facility expenses, which include costs associated with office space, have been relatively stable over the past two years. Facility costs during 2003 were $2,769 compared to $2,720 in 2002. Commensurate with the exit of e-business in May 2001, Calian consolidated its Ottawa-based personnel into one building while subletting another building that it had begun to lease in June 2000. As explained further in the discontinued operation section of this discussion, the Company's facility costs exclude lease and operating costs related to the excess space. Management believes that the existing facilities will be sufficient for the foreseeable future.

Amortization of capital assets

Amortization of capital assets totaled $1,216, compared with $1,573 in the previous year. The decrease is due to the lower rate of capital spending during 2002 and 2003, which affects the amortization expense in subsequent periods. The amortization level in the future is not expected to vary significantly from current levels.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Interest income, net

Interest income is earned on the Company's excess cash and cash equivalents and is shown net of the Company's interest expense associated with its long-term debt and capital leases. As a result of increased cash balances, interest income increased to $364 during the year, compared to $202 recorded in 2002.

Earnings before taxes and amortization of goodwill

The above factors have resulted in an increase of 51% in earnings before taxes and amortization of $8,782 for the year, compared to $5,797 in 2002.

Income taxes

Calian reports its results on a fully taxed basis, although significant cash taxes were not payable during 2003. The provision for income taxes during 2003 was $3,454 compared to $2,142 in 2002 commensurate with the level of earnings before tax. Total income taxes paid in 2003 were $314.

The Company continues to have income tax losses and research expenditures to reduce future earnings for tax purposes. The total pool available (federal) to reduce future earnings as at September 30, 2003 amounted to $7,857. This compares to $12,983 available to the Company at the end of 2002. Calian also has $866 in investment tax credits available to apply against future federal taxes payable. The Company has utilized substantially all of its loss carry-forwards and research and development expenditures for purposes of provincial income taxes at the end of 2003 and will therefore be required to pay provincial income taxes during 2004. The Company expects that it will be required to begin paying federal income taxes in 2005.

Goodwill

Effective October 1, 2002, the Company adopted the new recommendation of the Canadian Institute of Chartered Accountants with respect to the valuation of goodwill and other intangible assets. Under the new standard, the Company no longer amortizes goodwill. Instead, goodwill will be reviewed annually for impairment using a fair value method. The Company completed the transitional impairment test at October 1, 2002 and concluded that no write-down was necessary as a result of implementing the new standard. For 2003, the Company did not require a charge for goodwill impairment.

Earnings from continuing operations

The Company reported earnings from continuing operations of $5,328 or $0.66 per share basic and $0.64 per share diluted for 2003 compared to $3,419 or $0.41 per share basic and diluted for 2002.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Discontinued operation

As indicated in Note 9 of the Company's financial statements for the year ended September 30, 2003, Calian has a significant commitment with regards to premises leased during 2000 in anticipation of the e-business operation expansion and growth. As a result of the e-business operation being discontinued, the Company no longer requires this excess space. This lease commitment extends to April 2010. The space is currently sublet to a third party until May 2006. During 2003, the sub-tenant of this facility approached the Company and requested a review of the current sub-lease agreement. Calian and the sub-tenant were not able to agree on modifications that were acceptable to both parties. To date, the sub-tenant has fulfilled its sub-lease obligations and has indicated it will continue to do so. Management believed it was prudent to increase its existing provision related to the exit of the e-business operation and therefore recorded an additional loss on disposal of the e-business operation of $750 ($480 after tax) or $0.06 per share relating to the leased premises. This adjustment brings the total provision available for future real estate costs associated with the e-business discontinued operation to approximately $1.1 million.

Net earnings

The Company reported net earnings of $4,848 or $0.60 per share basic and $0.58 per share diluted for 2003 compared to $3,419 or $0.41 per share basic and diluted in 2002.

Operating results by quarter

The tables below provide certain financial information in summary form on a quarterly basis for the years 2003 and 2002.

The Company's operations have historically been subject to some quarterly seasonality due to the timing of vacation periods and statutory holidays. Typically the Company's first and last quarters will be negatively impacted as a result of the Christmas season and summer vacation period. During these periods, the Company can only invoice for work performed and is also required to pay employees for statutory holidays. This may result in reduced levels of revenues and in a decline in gross margins. However, due to the impact of the realized sales mix of its various projects, this quarterly seasonality may not be apparent in the overall results of the Company.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Selected Quarterly Financial Data

(dollars in thousands except per share data)
(unaudited)

	Quarters ended				
	Dec 31, 2002	March 31, 2003	June 30, 2003	Sept 30, 2003	Total 2003
Revenues	34,774	37,865	34,188	34,213	141,040
Cost of revenues	28,832	30,903	27,893	28,026	115,654
Gross profit	5,942	6,962	6,295	6,187	25,386
Selling, administration and other	4,246	4,372	4,202	4,148	16,968
Earnings before interest and income taxes	1,696	2,590	2,093	2,039	8,418
Interest income, net	48	86	106	124	364
Earnings before income taxes	1,744	2,676	2,199	2,163	8,782
Income taxes	685	1,057	913	799	3,454
Earnings from continuing operations	1,059	1,619	1,286	1,364	5,328
Loss on disposal of discontinued operation	-	480	-	-	480
Net Earnings	1,059	1,139	1,286	1,364	4,848
Earnings per share from continuing operations					
Basic	0.13	0.20	0.16	0.17	0.66
Diluted	0.13	0.19	0.16	0.16	0.64
Net earnings per share					
Basic	0.13	0.14	0.16	0.17	0.60
Diluted	0.13	0.13	0.16	0.16	0.58
Weighted average number of shares					
Basic	8,012,778	7,974,689	7,999,225	8,159,519	8,047,748
Diluted	8,280,127	8,381,728	8,283,895	8,455,212	8,389,822

BALANCE SHEET DATA

	Dec 31, 2002	March 31, 2003	June 30, 2003	Sept 30, 2003
Working capital	14,282	15,937	17,629	19,570
Total assets	54,799	55,140	62,332	64,067
Long-term debt including current portion	304	262	220	181
Shareholders' equity	26,130	26,675	27,662	28,974

Management's Discussion and Analysis of Financial Condition and Results of Operations

Selected Quarterly Financial Data

(dollars in thousands except per share data)
(unaudited)

	Quarters ended Dec 31, 2001	March 31, 2002	June 30, 2002	Sept 30, 2002	Total 2002
Revenues	$ 30,265	$ 33,245	$ 34,178	$ 34,188	$ 131,876
Cost of revenues	25,219	27,462	28,332	28,044	109,057
Gross profit	5,046	5,783	5,846	6,144	22,819
Selling, administration and other	4,351	4,316	4,076	4,481	17,224
Earnings before interest, taxes and amortization of goodwill	695	1,467	1,770	1,663	5,595
Interest income, net	64	29	50	59	202
Earnings before taxes and amortization of goodwill	759	1,496	1,820	1,722	5,797
Income taxes	350	611	681	500	2,142
Earnings before amortization of goodwill	409	885	1,139	1,222	3,655
Amortization of goodwill	59	59	59	59	236
Net Earnings	$ 350	$ 826	$ 1,080	$ 1,163	$ 3,419
Net earnings per share					
Basic	$ 0.04	$ 0.10	$ 0.13	$ 0.14	$ 0.41
Diluted	$ 0.04	$ 0.10	$ 0.13	$ 0.14	$ 0.41
Weighted average number of shares					
Basic	9,179,049	8,030,518	8,047,923	8,023,873	8,320,341
Diluted	9,185,658	8,137,142	8,222,634	8,209,451	8,438,721

BALANCE SHEET DATA

	Dec 31, 2001	March 31, 2002	June 30, 2002	Sept 30, 2002
Working capital	7,181	9,139	11,137	13,380
Total assets	49,642	50,797	49,809	55,027
Long-term debt including current portion	465	426	386	345
Shareholders' equity	22,811	23,822	24,716	25,908

Management's Discussion and Analysis of Financial Condition and Results of Operations

Liquidity and Capital Resources

Calian's net cash position was $25,185 at September 30, 2003, compared to $9,488 at September 30, 2002. Cash flows provided from operating activities in 2003 were $18,678 as compared with $3,168 during 2002.

In addition to cash, the principal components of the Company's working capital are accounts receivable and work in process, offset by accounts payable and unearned contract revenue. The systems engineering market is characterized by long-term contracts with billings tied to milestones achieved, which often results in significant working capital requirements. Conversely, given the nature of this business, it is sometimes possible to negotiate advance payments on contracts. For example, during 2003, the Company was able to negotiate a $10 million advance payment relating to the ESA project. Such advance payments give rise to unearned revenue that will be realized as revenue over the course of the contract. As at September 30, 2003, the Company's total unearned revenue amounted to $18,045. This compares to $13,483 one year earlier. It is expected that unearned revenue will decrease over the upcoming year as the related work is performed and obtaining advance payments on new projects may become more difficult.

Calian acquired $1,044 in capital assets during 2003, compared to $788 during 2002. Assets purchased in 2003 are in line with normal requirements for asset replacement. During 2004, capital expenditures are expected to be in line with past years. At September 30, 2003 there were no significant commitments to expend capital.

As a result of continuing earnings and a strong cash position, the Company introduced a dividend during 2003 and paid $1,374 or $0.17 cents per share. The Company intends to continue with its current dividend policy for the foreseeable future and expects to pay quarterly dividends of $0.05 to shareholders.

The Company repaid $155 of capital leases and other debt during 2003. Total long-term debt, including the current portion, amounted to $181 at September 30, 2003. The amount payable within the next year is $92.

During 2002, the Company acquired 1,786,956 or 18.3% of its outstanding common shares under a Substantial Issuer Bid for a total of $5.3 million or $2.80 per share. In addition, 130,528 shares were issued for cash and 79,500 shares were repurchased under the Company's Normal Course Issuer Bid.

During 2003, the Company acquired 316,300 common shares under Normal Course Issuer Bids at an average price of $6.03 and 489,593 shares were issued for cash.

At September 30, 2003 there were 8,212,066 common shares outstanding.

At September 30, 2003 the Company had a short-term credit facility of $10,000 with a Canadian chartered bank that bears interest at prime and is secured by assets of the Company. The ability of the Company to draw on this credit facility depends on the level of its accounts receivable and its meeting certain financial covenants.

Management believes that Calian has sufficient cash resources to finance its working capital requirements during 2004, pay a quarterly dividend and repay long-term debt as it comes due.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Significant Accounting Policies and Estimates

In 2003, the Company's most complex accounting policies and estimates were made in the area of revenue recognition on fixed-price projects, valuation of income taxes and goodwill.

Revenue recognition

The Business and Technology Services Division's revenue is derived from cost-plus contracts where revenue is recognized when the services are provided. However, a significant portion of the Systems Engineering Division's revenue is derived from fixed-price contracts. Revenue from these fixed-price projects is recognized using the percentage of completion method using management's best estimate of the costs to complete the projects. The greatest risk on fixed-price contracts is the possibility of cost overruns. Management's approach to revenue recognition is tightly linked to detailed project management processes and controls. The information provided by the project management system combined with a knowledgeable assessment of technical complexities and risks are used in estimating the percentage completion.

Future income taxes

Income tax assets relate to the Company's future tax benefits, which include future tax deductions, loss carry-forwards and research and development expenditures. The valuation of tax assets is based on the amount of tax benefits available combined with the determination as to when the tax benefits will be realized and the tax rate in effect at that time. The Company has significant tax benefits that will be realized over several years. Because of the current declining tax rate structure, the year in which the Company realizes these benefits has a significant impact on the valuation. The tax assets are based on management's best estimate of the timing of recovery of these tax benefits.

Goodwill

The valuation of goodwill is based on a valuation of the reporting unit to which goodwill is attributed. To the extent that the valuation exceeds the net book value of the related reporting unit, no write-down is necessary. The valuation is based on management's best estimate of future results of operations using reasonable assumptions relating to growth levels, expected costs, expected business environment and the Company's weighted average cost of capital.

Impact of Accounting Pronouncements Not Yet Implemented

For the year beginning in October 2003, Calian is required to adopt the recommendations amending section 3870-Stock-based Compensation and will be required to measure and recognize shares issued to employees under the Employee Stock Purchase Plan using the fair value based method. The impact of this new accounting recommendation is not expected to be significant.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Corporate Governance

Calian has continuously reviewed its corporate governance practices and has made changes as required.

In 2001, Calian began to address auditor independence issues by requesting a change in audit partners and implementing a policy limiting non-audit services from its current auditing firm.

In 2002, the Company dropped its existing stock option plan, modified its employee share purchase plan and began paying a dividend to shareholders. In addition, the Board appointed a Lead Director to ensure the Board of Directors could properly discharge its corporate governance responsibilities.

In 2003, more changes were adopted. The Board was rejuvenated when one long time Board member retired and three new Board members joined the team, increasing the number of Board members to seven of whom six are independant. One of these new Board members is a financial expert and sits on the Audit Committee. In addition, the Board members now meet on a regular basis without management present.

Long-term Strategy

Calian's long-term strategy is to continue providing services to industry and government to help them implement new technologies in a cost-effective manner. Calian's approach is to continue to focus in specialized niche areas outside the mainstream market, avoiding competition with larger competitors. Calian will focus its energy in providing services that the Company believes its competitors either do not want to provide or cannot provide efficiently.

Calian's strategies for growth are simple—to expand on current capabilities to address a wider range of customers with a broader range of services while at the same time maintaining the commitment to quality and delivery. Internally, the Compnay plans to augment its service offerings and capitalize on Calian's reputation for delivery and its satisfied base of blue-chip customers. At the same time, the Company plans to acquire specialized technology companies that have also had success in profitably addressing niche markets and whose operating philosophies align with Calian's philosophies. With growing revenues, an efficient back office, and the realization of economies of scale, the Company expects to enhance the returns to its shareholders while at the same time continuing to build an enterprise that excels in its selected markets.

For existing operations, the key premise is controlled profitable growth. The Company recognizes that growth will not only extract economies of scale and provide additional returns, but will also provide an environment for its people to grow and advance within the Company. Calian's strengths in delivering specialized technology services in niche markets have so far permitted the Company to excel in a difficult business environment where many mainstream competitors have faltered. With the backdrop of continuing to do what Calian does best, there are no grand strategies to materially alter the business of the Company. Calian's strategies and tactics revolve around maintaining its growth plans in traditional and adjacent markets and refining operating processes to deliver services in the most efficient and profitable means possible.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The Company will consider expanding its operations through strategic acquisitions. Management has created a list of criteria that is designed to identify those candidates that would best compliment Calian's existing businesses.

- The candidate company must be highly specialized, providing a unique service to a specific and loyal customer base.
- The incumbent management team must be passionate and dedicated, and be interested in continuing to run the company as an autonomous division of Calian.
- The candidate must demonstrate consistent earning power.
- The candidate must yield solid returns and employ very little capital.
- The candidate must show audited results of a minimum of $1.5 million EBITDA over the last year.
- The owners must have a price in mind that can be expressed as a multiple of last year's EBITDA.
- Careful review of these candidates will be undertaken to ensure that acquisitions will be economically justified and will increase shareholder value.

Risk Factors

The Company is subject to a number of risks and uncertainties that could significantly affect the Company's future results of operations and financial condition. The Company has a comprehensive planning process where risks are identified and plans initiated to minimize risks wherever possible. All participants in the Systems Engineering and Business and Technology Services divisions face some or all of the following risks and uncertainties:

Competition for contracts within key markets

The markets for the Company's services are intensely competitive, rapidly evolving and subject to technological changes. The principal competitive factors in the Company's markets are quality, performance, price, timeliness, customer support and reputation. Calian has a disciplined approach to management of all aspects of its business. The Company is a proponent of quality management and its Systems Engineering Division is registered under ISO 9001 - 2000 standards while its Business and Technology Services Division is accredited at Level 2 of the Progressive Excellence Program by the National Quality Institute. This approach to management was developed to help Calian ensure that its employees deliver services consistently according to the Company's high standards and based on strong values underlying its client-focused culture. As a result, the Company has achieved one of the industry's highest contract win and renewal rates.

The availability of qualified professionals

Competition from other firms has a two-fold impact on the Company. Calian must not only vie for qualified employees for its own operations but must have ready access to a large pool of qualified professionals to satisfy contractual arrangements with customers. Calian mitigates these factors through a number of means. Calian's performance-driven remuneration policies and its favourable working environment are conducive to attracting ambitious, qualified professionals. As a supplier of professional employees through outsourcing contracts, Calian regularly establishes relationships with a significant number of professionals in key markets.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Performance on fixed-price contracts

A large percentage of the Systems Engineering Division's contracts are based on a fixed-price for the provision of a specified service against an agreed delivery schedule. These fixed-price contracts at times involve the completion of large-scale system engineering projects. There is a risk in all fixed-price contracts that the Company will be unable to deliver the system within the time specified and at the expected cost. The Company employs sophisticated design and testing processes and practices, which include a range of stringent factory and on-site acceptance tests with criteria and requirements jointly developed with the customer. However, non-performance could result in a customer being in a position to terminate the contract for default, or to demand repayments or penalties. Program management methodologies have been implemented to adequately manage each project and any customer changes, and to identify and mitigate potential technical risks and related cost overruns. In addition, Calian employs procedures to ensure accurate estimating of costs and performs regular detailed reviews of progress on each project.

Non-performance of a key supplier or contractor

The Company's business is often dependent on performance by third parties and subcontractors for completion of contracts for which Calian is the prime contractor. Subcontractors for large systems are selected in concurrence with the customer's requirements, and if not directed by the customer, are selected through a competitive bid or negotiated process. Most major development subcontracts are established as fixed-price contracts. The Company believes that these subcontractors have an economic incentive to perform such subcontracts for the Company. However, no company can protect itself against all material breaches, particularly those related to financial insolvency of the subcontractors or to cost overruns by subcontractors. Risks include a significant price increase in those few subcontracts that are not fixed-price, delay in performance, a failure of any major subcontractor to perform or the inability of the Company to obtain replacement subcontractors at a reasonable price. The performance of key subcontracts is closely monitored as part of the Company's project management process to promptly identify potential issues and develop remedial actions.

Rapidly changing technologies and customer demands

The markets in which Calian operates are characterized by changing technology and evolving industry standards. Calian keeps pace with developments in the industries it serves and actively monitors the evolution of these markets, thus ensuring that it can meet the evolving needs of its clients. The Company achieves the aforementioned through continually recruiting professionals in high demand positions and providing regular training to ensure employee skills remain current. The Company's ability to anticipate changes in technology, technical standards and service offerings will be a significant factor in the Company's ability to compete or expand into new markets.

Government Contracts

During 2003, approximately 38% of the Company's total revenues were derived from contracts with the Canadian government and its agencies. The government may change its policies, priorities or funding levels through agency or program budget reductions or impose budgetary constraints. Furthermore, contracts with governments, including the Canadian government, may be terminated or suspended by the government at any time, with or without cause. Although in the past the Company has not experienced any significant cancellations of previously awarded contracts by the Canadian government, there can be no assurance that any contract with the government will not be terminated or suspended in the future.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Credit risk concentration with respect to trade receivables

As the Company grows, it monitors the concentration of its business in its various segments and with particular customers. In management's opinion, the fact that the Company operates in two segments that provide some diversification of its customer base mitigates the potential impact on earnings and cash flow of problems related to an individual sector or customer. The Company does extensive in-bound call center business with a large private sector customer. The Company monitors the quality of its services to this customer to ensure long-term viability of the contract. Also, processes have been established to mitigate the Company's credit exposure with this customer.

Insufficient or inappropriate mix of work for fixed labour resources

Virtually all employees of the Systems Engineering Division are full time staff and represent a broad spectrum of unique skill sets. Accordingly, the division strives to secure sufficient labour sales that adequately match the skill sets. The division's business development practices are designed to dynamically adjust pursuits of contracts to address the sufficiency and mix of available resources.

Operational risk

Operational risk is managed through the establishment of effective infrastructure and controls. Key elements of the infrastructure are qualified, well-trained personnel, clear authorization levels and reliable technology. Controls established by documented policies and procedures include the regular examination of internal controls by our auditors, segregation of duties, and financial management and reporting. In addition, the Company maintains insurance coverage and contingency plans for systems failure or catastrophic events.

Foreign currency risk

The Company operates internationally, with approximately 31% of its business derived from non-Canadian sources. A substantial portion of this international business is denominated in major foreign currencies, and therefore the Company's results from operations are affected by exchange rate fluctuations of these currencies relative to the Canadian dollar. The Company uses financial instruments, principally in the form of forward exchange contracts, in its management of foreign currency exposures. At September 30, 2003 the Company had various forward exchange contracts, which are explained in Note 12 to the Company's consolidated financial statements for the year ended September 30, 2003. The strengthening of the Canadian dollar relative to other foreign currencies may impact the Company's competitiveness and increase pressure on margins for new work.

Legal proceedings

The Company is involved in several lawsuits that are described in Note 8 to the Company's consolidated financial statements for the year ended September 30, 2003. These matters are at various stages of litigation and the outcomes of these matters are not determinable at this time.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Discontinued operation

As part of its e-business strategy, the Company entered into a 10-year lease for an office building in the Ottawa area extending to April 2010. Upon exit of the e-business sector, the Company did not have any requirements for the space and accordingly sublet the excess space to a third party for a period of five years ending May 2006. In the event the sub-lessee defaults on the payments or the Company cannot sublet the premises for the remaining four years, Calian will be required to assume the lease including related operating costs for the remaining term of the lease. The total annual cost of the lease and related operating costs is approximately $960.

Outlook for 2004

The Systems Engineering Division has been working within a depressed satellite sector for the last few years and no significant rebound is expected in 2004. While Calian has the benefit of a healthy backlog, continued strengthening of the Canadian dollar may impact the Systems Engineering Division's competitiveness when bidding against foreign competition on projects denominated in US dollars.

The Business and Technology Services Division is noticing some delays in new program funding and a lengthened procurement cycle within the Federal Government. This could impact the level of new business available from the Federal Government next year.

Despite these market conditions the Company enters 2004 with a healthy backog. In addition, a large manufacturing contract for the security and surveillance market won in the fall of 2003 will provide significant growth for 2004. Follow on work relative to this contract is dependant on continued requirements for similar systems.

Disclaimer

This annual report may contain forward-looking statements that involve a number of risks and uncertainties, including statements regarding the outlook for the Company's business and results of operations. By nature, these risks and uncertainties could cause actual results to differ materially from those indicated. Such factors include, without limitation, the various factors set forth in the Management Discussion and Analysis section of this report and as discussed in public disclosure documents filed with Canadian regulatory authorities. Calian disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Management's Statement of Responsibility

The accompanying consolidated financial statements of Calian Technology Ltd. and its subsidiaries and all information in the annual report are the responsibility of management and have been approved by the Board of Directors. The financial statements include some amounts that are based on management's best estimates that have been made using careful judgment.

The financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Financial and operating data elsewhere in the annual report are consistent with the information contained in the financial statements.

In fulfilling its responsibilities, management of Calian and its subsidiaries has developed and continues to maintain systems of internal accounting controls, including written policies and procedures and segregation of duties and responsibilities.

Although no cost-effective system of internal controls will prevent or detect all errors and irregularities, these systems are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use, transactions are properly recorded and the financial records are reliable for preparing the financial statements.

The Board of Directors carries out its responsibility for the financial statements in this report through its Audit Committee. The Audit Committee meets periodically with management and with the external auditors to discuss the results of audit examinations with respect to the adequacy of internal controls and to review and discuss the financial statements and financial reporting matters.

The financial statements have been audited by Deloitte & Touche LLP, Chartered Accountants, who have full access to the Audit Committee with and without the presence of management.

Larry O'Brien
Chairman and CEO

Jacqueline Gauthier
Chief Financial Officer

Kanata, Ontario
October 30, 2003

Auditors' Report

To the Shareholders of Calian Technology Ltd.

We have audited the consolidated balance sheets of Calian Technology Ltd. as at September 30, 2003 and 2002 and the consolidated statements of earnings and retained earnings and of cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2003 and 2002 and the results of its operations and the changes in its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants

Ottawa, Ontario
October 30, 2003

Consolidated Statements of Earnings and Retained Earnings

Years Ended September 30, 2003 and 2002

(dollars in thousands, except per share data)

		2003		2002
Revenues	$	141,040	$	131,876
Cost of revenues		115,654		109,057
Gross profit		25,386		22,819
Selling and marketing		4,409		4,601
General and administration		8,574		8,330
Facilities		2,769		2,720
Amortization of capital assets		1,216		1,573
Earnings before interest, taxes and amortization of goodwill		8,418		5,595
Interest income, net		364		202
Earnings before taxes and amortization of goodwill		8,782		5,797
Income tax expense (Note 3):				
Current		1,279		745
Future		2,175		1,397
		3,454		2,142
Earnings before amortization of goodwill		5,328		3,655
Amortization of goodwill		-		236
Earnings from continuing operations		5,328		3,419
Loss on disposal of discontinued operation (net of income taxes) (Note 14)		480		-
NET EARNINGS		4,848		3,419
Retained earnings, beginning of year		11,057		9,797
Excess of purchase price over stated capital on repurchase of shares (Note 6)		(1,329)		(2,159)
Dividend		(1,374)		-
Retained earnings, end of year	$	13,202	$	11,057
Earnings per share from continuing operations (Note 7)				
Basic	$	0.66	$	0.41
Diluted	$	0.64	$	0.41
Net earnings per share (Note 7)				
Basic	$	0.60	$	0.41
Diluted	$	0.58	$	0.41
Weighted average number of shares (Note 7)				
Basic		8,047,748		8,320,341
Diluted		8,389,822		8,438,721

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Balance Sheets

As at September 30, 2003 and 2002

(dollars in thousands)

	2003	2002
ASSETS		
Currents assets		
Cash and cash equivalents	$ 25,185	$ 9,488
Accounts receivable	20,519	25,307
Work in process	4,759	3,472
Prepaid expenses and other	486	726
Future income taxes (Note 3)	3,625	3,325
	54,574	42,318
Investment tax credits recoverable (Note 3)	866	1,705
Future income taxes (Note 3)	1,271	3,476
Capital assets (Note 4)	4,110	4,282
Goodwill	3,246	3,246
	$ 64,067	$ 55,027
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	$ 16,867	$ 15,291
Unearned contract revenue	18,045	13,483
Current portion of long-term debt	92	164
	35,004	28,938
Long-term debt (Note 5)	89	181
	35,093	29,119
Contingencies (Note 8)		
Shareholders' equity		
Share capital (Note 6)	15,772	14,851
Retained earnings	13,202	11,057
	28,974	25,908
	$ 64,067	$ 55,027

The accompanying notes are an integral part of the consolidated financial statements.

Approved by the Board:

Larry O'Brien
Director

William G. Breen
Director

Consolidated Statements of Cash Flows

Years Ended September 30, 2003 and 2002

(dollars in thousands)

	2003	2002
CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES		
Net earnings	$ 4,848	$ 3,419
Items not affecting cash		
Deferred lease inducements	(9)	(9)
Amortization	1,216	1,809
Investment tax credits	839	471
Future income taxes	1,905	1,397
	8,799	7,087
Change in non-cash working capital		
Accounts receivable	4,788	(6,913)
Work in process	(1,287)	393
Prepaid expenses and other	240	28
Accounts payable and accrued liabilities	1,576	(762)
Unearned contract revenue	4,562	3,335
	18,678	3,168
CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES		
Repayment of debt	(155)	(151)
Issuance of common shares	1,510	334
Repurchase of common shares, including cost associated with repurchase (Note 6)	(1,918)	(5,586)
Dividend	(1,374)	-
	(1,937)	(5,403)
CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES		
Acquisition of capital assets	(1,044)	(788)
Note receivable	-	300
	(1,044)	(488)
NET CASH INFLOW (OUTFLOW)	15,697	(2,723)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	9,488	12,211
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 25,185	$ 9,488

Supplementary Information:

	2003	2002
Income taxes paid	$ 314	$ 14
Interest paid	$ 7	$ 46

The accompanying notes are an integral part of the consolidated financial statements.

Notes to the Consolidated Financial Statements

As at September 30, 2003 and 2002

(dollars in thousands, except per share data)

1. Nature of Operations

Calian Technology Ltd. ("the Company"), incorporated under the Canada Business Corporations Act, and its wholly owned subsidiaries provide technology services to industry and government.

2. Accounting Policies

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the following significant accounting policies:

Basis of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries Calian Ltd, Calian Inc. and Calian Technology (U.S.) Ltd.

Revenue recognition

Income on contracts is recognized at the net realizable value of services provided using the percentage of completion method based on management estimates. Billings and cash receipts in advance of amounts earned are reflected as unearned contract revenue. Provision is made for the entire amount of the expected losses, if any, in the period in which they are first determinable. In addition, a provision for warranty claims is established when revenue is recognized, based on warranty terms and prior claim experience. As some contracts extend over one or more years, any revision in cost and profit estimates made during the course of the work are reflected in the accounting period in which the facts indicating a need for the revision become known.

Work in process

Work in process represents work performed but not invoiced and is recorded at net realizable value.

Capital assets

Capital assets are recorded at cost, net of related government assistance and investment tax credits. Amortization is calculated using the declining balance method at rates ranging from 20% to 30%.

Goodwill and other intangible assets

Effective October 1, 2002, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants Handbook Section 3062, Goodwill and Other Intangible Assets. Under the revised Section 3062, goodwill and intangible assets with an indefinite life will no longer be amortized to earnings and will be assessed for impairment on an annual basis in accordance with the new standards, including a transitional impairment test whereby any resulting impairment will be charged to opening retained earnings. During the twelve month period ending September 30, 2003, the effect of the non-amortization of goodwill resulted in an increase in the consolidated net earnings of $236 or $0.03 per share. The Company completed the transitional impairment test at October 1, 2002 and concluded that no write-down is necessary as a result of implementing the new standards.

Notes to the Consolidated Financial Statements

Years Ended September 30, 2003 and 2002

(dollars in thousands, except per share data)

2. Accounting Policies (continued)

Income taxes

The Company and its subsidiaries account for income taxes using the liability method. Under this method, current income taxes are recognized for the estimated income taxes payable for the current year. Future income tax assets and liabilities are recognized for temporary differences between the tax and accounting bases of assets and liabilities and for the benefit of tax losses available to be carried forward to future years if these are likely to be realized.

Stock-based compensation

Effective October 1, 2002, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants Handbook Section 3870, Stock-based Compensation and Other Stock-based Payments and in accordance with the recommendations has applied them only to awards granted on or after the date of the adoption. The new standard requires that all stock based awards made to non-employees be measured and recognized using the fair-value based method. Options granted to employees and shares issued to employees under the Employee Stock Purchase Plan (ESPP) may be accounted for using either the fair-value based method or other common practice. As such, the Company has continued the use of the settlement method of accounting for stock-based compensation awards granted to employees. Accordingly, no compensation expense is recognized for options granted and shares issued to employees under the ESPP. Any consideration paid by employees for the purchase of shares is credited to share capital.

Disclosure of guarantees

Effective fiscal 2003, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants Accounting Guideline 14, Disclosure of Guarantees. This guideline requires a guarantor to disclose in its notes to the consolidated financial statements significant information about guarantees it has provided. Under this guideline, a guarantee is defined as a contract or indemnification agreement, which requires the Company to make payments to a third party contingent on future events. The disclosures described in Note 10 are required even when the likelihood of the guarantor having to make any payment under the guarantee is remote.

Foreign currency translation

The accounts of a wholly owned subsidiary, which is considered to be an integrated subsidiary, and accounts in foreign currencies have been translated into Canadian dollars using the temporal method of foreign currency translation. Under this method, monetary assets and liabilities are translated at the rate of exchange in effect at year-end. Non-monetary items are translated at rates in effect on the dates of the transactions. Revenues and expenses are translated at rates in effect during the year except for amortization, which is translated at the same rate as the assets to which it relates. Gains and losses from translation are included in earnings in the year in which they occur.

Notes to the Consolidated Financial Statements

Years Ended September 30, 2003 and 2002

(dollars in thousands, except per share data)

2. Accounting Policies (continued)

Financial instruments and risk management

The carrying amount of the Company's current monetary assets and liabilities approximate fair value.

Derivative financial instruments are utilized by the Company in the management of its foreign currency exposures. The Company's policy is not to utilize derivative financial instruments for trading or speculative purposes.

In 2003, the Company early adopted the Canadian Institute of Chartered Accountants Accounting Guideline 13, Hedging Relationships. Accordingly, the Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific firm contractually related commitments on projects. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The Company hedges foreign currency exposures by entering into offsetting forward exchange contracts. Foreign exchange translation gains and losses on foreign currency denominated derivative financial instruments used to hedge foreign currency denominated contracts are deferred and recognized as an adjustment of either the hedged revenues or the hedged project costs.

Realized and unrealized gains or losses associated with derivative instruments, which have been terminated or cease to be effective prior to maturity, are deferred under other current or non-current assets or liabilities on the balance sheet and recognized in income in the period in which the underlying hedged transaction is recognized. In the event a designated hedged item is extinguished, settled or is no longer probable of occurring prior to the termination of the related derivative instrument, any realized or unrealized gain or loss on such derivative instrument is recognized as an adjustment to revenue or cost of the related project.

Earnings per share

Diluted earnings per share is calculated based on the weighted average number of common shares outstanding during the period plus the effects of potentially dilutive common shares outstanding during the period. This method requires that the dilutive effect of outstanding options be calculated using the treasury stock method, as if all dilutive options had been exercised at the later of the beginning of the reporting period or date of issuance, and that the funds obtained thereby were used to purchase common shares of the Company at the average trading price of the common shares during the period.

Cash and cash equivalents

Cash and cash equivalents include investments with a major Canadian chartered bank and money market instruments that have terms of three months or less at the time of acquisition. The carrying amounts of cash and cash equivalents are stated at cost, which is equal to their fair value.

Notes to the Consolidated Financial Statements

Years Ended September 30, 2003 and 2002

(dollars in thousands, except per share data)

3. Income Taxes

The balances of future income tax assets (current and long-term) at September 30, 2003 represent the future benefits of temporary differences between the tax and accounting bases of assets and liabilities, consisting mainly of future tax deductions, research and development expenditures and losses available to be carried forward for tax purposes to the extent that they are likely to be realized.

Research expenditures

The Company and its subsidiaries have $7,523 of federal research expenditures (provincial: NIL) available to reduce future earnings for tax purposes. This amount may be carried forward indefinitely but will be reduced by any related investment tax credits claimed.

Income tax losses

The Company and its subsidiaries have $334 of federal and provincial losses available to reduce future earnings for income tax purposes, which expire in 2005.

Investment tax credits

The Company and its subsidiaries have investment tax credits available to apply against future federal income taxes payable, which expire as follows:

2007	$ 105
2008 and thereafter	761
	$ 866

The future tax assets of the Company are comprised of the following elements:

	2003	2002
Income tax losses	$ 115	$ 1,184
Research and development expenditures	1,469	2,416
Tax base of assets in excess of book base	1,209	1,356
Book base of liabilities in excess of tax base	2,103	1,845
	4,896	6,801
Current	3,625	3,325
Long-term	$ 1,271	$ 3,476

Notes to the Consolidated Financial Statements

Years Ended September 30, 2003 and 2002

(dollars in thousands, except per share data)

3. Income Taxes (continued)

The following table reconciles the difference between the income taxes that would result solely by applying statutory tax rates to pre-tax income and the income taxes actually provided in the accounts:

	2003	2002
Earnings before taxes and amortization of goodwill	$ 8,782	$ 5,797
Amortization of goodwill	-	236
Earnings before income taxes	8,782	5,561
Tax provision at the combined basic Canadian federal and provincial income tax rate of 37.8% (2002, 39.9%)	3,320	2,219
Increase (decrease) resulting from:		
Non-deductible amortization	-	94
Other permanent differences	74	43
Impact of rate reductions on valuation of future income tax assets	(9)	(270)
Other	69	56
	$ 3,454	$ 2,142

4. Capital Assets

	2003			2002
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Equipment, furniture and fixtures	$ 10,221	$ 6,111	$ 4,110	$ 4,282

5. Long-Term Debt

	2003	2002
Capital leases at rates ranging from 5.5% to 7.4% per annum, secured by underlying assets	$ 134	$ 289
Other non-interest bearing	47	56
	181	345
Less amounts due within one year	92	164
	$ 89	$ 181

Principal amounts are due as follows:		
	2004	$ 92
	2005	61
	2006	9
	2007 and thereafter	19

Notes to the Consolidated Financial Statements

Years Ended September 30, 2003 and 2002

(dollars in thousands, except per share data)

6. Share Capital

Authorized

Unlimited number of common shares

Unlimited number of preferred shares issuable in series

Issued

Common shares as follows:

	2003		2002	
	Shares Issued	Amount	Shares Issued	Amount
Balance, beginning of year	8,038,773	$ 14,851	9,774,701	$ 17,944
Shares issued for cash	489,593	1,510	130,528	334
Shares repurchased	(316,300)	(589)	(1,866,456)	(3,427)
Balance, end of year	8,212,066	$ 15,772	8,038,773	$ 14,851

During 2003, the Company acquired 316,300 of its outstanding shares at an average price of $6.03 per share for a total of $1,918 through Normal Course Issuer Bids initiated in May 2002 and May 2003 each for a period of one year. The excess of the purchase price over the average stated capital of the shares has been charged to retained earnings.

During 2002, the Company acquired 1,786,956 (or 18.3%) of its outstanding common shares at a price of $2.80 per share, for a total of $5,280 including related expenses of $276, through a Substantial Issuer Bid procedure known as a Dutch Auction and acquired 79,500 at an average price of $3.85 per share for a total of $306 through a Normal Course Issuer Bid initiated in May 2002. The excess of the purchase price over the average stated capital of the shares has been charged to retained earnings.

Share options

The Company established a stock option plan, whereby grants were made at the sole discretion of the Company's Board of Directors. Under this plan, eligible directors and employees were granted the right to purchase shares of common stock at a price established by the Board of Directors on the date the options were granted. The plan which expired in 2003 was not renewed and no options were granted during 2003.

These purchase options have been granted with vesting terms ranging from immediately to over three years and a maximum term to expiry of five years, and are contingent on the option holders maintaining their employment.

	2003		2002	
	Options	Weighted Avg. ExercisePrice	Options	Weighted Avg. Exercise Price
Outstanding, beginning of year	944,280	$3.23	723,915	$3.75
Granted		$ -	435,000	$2.61
Exercised	(465,905)	$3.11	(95,500)	$2.45
Forfeited or expired	(10,835)	$6.60	(119,135)	$4.75
Outstanding, end of year	467,540	$3.28	944,280	$3.23

Notes to the Consolidated Financial Statements

Years Ended September 30, 2003 and 2002

(dollars in thousands, except per share data)

6. Share Capital (continued)

As at September 30, 2003:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Options	Weighted Avg. Remaining Contractual Life (Yrs)	Weighted Avg. Exercise Price	Number Exercisable	Weighted Avg. Exercise Price
\$2.25 - \$2.65	272,825	3.17	\$2.45	42,425	\$2.45
\$2.80 - \$3.20	43,395	2.38	\$2.97	12,495	\$3.03
\$3.45 - \$3.80	47,500	2.92	\$3.64	12,500	\$3.75
\$4.25 - \$4.35	59,000	1.24	\$4.33	59,000	\$4.33
\$5.30 - \$6.90	44,820	1.82	\$6.85	43,100	\$6.90
	467,540	2.70	\$3.28	169,520	\$4.38

Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan (ESPP) under which most full-time employees may register once a year to participate in one of two offering periods. Eligible employees may purchase common shares by payroll deduction throughout the year at a price of 80% of the fair market value at the beginning of the initial offering period or may purchase common shares at a price of 90% of the fair market value at the beginning of the interim offering period. Such shares are issued from treasury once a year at the end of the offering periods.

A total of 500,000 common shares have been authorized for issuance under the plan. During fiscal 2003, the Company issued 23,688 shares under the ESPP and employees subscribed to approximately 43,403 common shares which will be issued during fiscal 2004 at a price of \$4.74. Since inception and including the issuance of shares in 2003, 120,611 shares have been issued under the plan.

7. Earnings Per Share

The diluted weighted average number of shares has been calculated as follows:

	September 30	
	2003	2002
Weighted average number of shares - basic	8,047,748	8,320,341
Additions to reflect the dilutive effect of employee stock options	342,074	118,380
Weighted average number of shares - diluted	8,389,822	8,438,721

Options that are anti-dilutive because the exercise price was greater than the average market price of the common shares are not included in the computation of diluted earnings per share. For fiscal 2003, 45,600 stock options were excluded from the above computation of diluted weighted average number of shares because they were anti-dilutive (2002, 356,680).

Notes to the Consolidated Financial Statements

Years Ended September 30, 2003 and 2002

(dollars in thousands, except per share data)

8. Contingencies

The Company is party to several claims aggregating approximately $450, which are being contested. The potential outcomes of these matters are not determinable at this time. The Company intends to defend these actions, and management believes that the resolution of these matters will not have a material adverse effect on the Company's financial condition.

In prior years the Company received assistance from the Government of Canada relating to research and development activities amounting to approximately $2,648. This assistance may be repayable based on future sales of the projects funded. A liability will be recognized in the period in which conditions arise that cause repayment. At September 30, 2003 no provision for payment is required.

9. Commitments

The Company has lease agreements with terms extending to the year 2010. The aggregate minimum rental payments under these arrangements are as follows:

2004	$	3,176
2005		2,664
2006		2,660
2007		2,677
Subsequent years		4,299

As part of its e-business strategy, during the year 2000, the Company entered into a 10-year lease for an office building in the Ottawa area extending to April 2010. Upon exit of the e-business sector in 2001, the Company did not have any requirements for the space and accordingly sublet the excess space to a third party for a period of five years ending May 2006. In the event the sub-lessee defaults on the payment or the Company cannot sublet the premises for the remaining four years, Calian will be required to assume the lease including related operating costs for the remaining term of the lease. The lease payments including operating costs relating to the excess space amount to approximately $960 per year.

10. Guarantees

In the normal course of business, the Company enters into agreements that may provide for indemnification and guarantees to customers in transactions such as staffing, outsourcing and engineering. These indemnification undertakings and guarantees may require the Company to compensate customers for costs and losses incurred as a result of various events, including breaches of representations and warranties, intellectual property right infringement, claims that may arise while providing services, or as a result of litigation that may be suffered by customers. The Company mitigates its responsibility by removing from its contracts clauses relating to liability for indirect or special damages such as loss of revenue or profit in all of its engineering agreements. The Company also mitigates the risk of loss by including similar indemnification clauses in the agreements entered into with its subcontractors. The term and nature of these indemnifications vary based upon the agreement, which often provides no limit. Consequently, the Company is unable to make a reasonable estimate of the maximum potential amounts that the Company could be required to pay to its customers. Historically, the Company has not been obligated to make significant payments under these indemnification clauses.

Notes to the Consolidated Financial Statements

Years Ended September 30, 2003 and 2002

(dollars in thousands, except per share data)

11. Segmented information

Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, regarding how to allocate resources and assess performance. The Company's chief operating decision maker is the Chief Executive Officer.

The Company operates in two reportable segments described below, defined by their primary type of service offering, namely Systems Engineering and Business and Technology Services.

- Systems Engineering involves planning, designing and implementing solutions that meet a customer's specific business and technical needs, primarily in the satellite communications sector.
- Business and Technology Services involves both short and long-term placements of personnel to augment work forces (Staffing) as well as the long-term management of projects, facilities and customer business processes (Outsourcing).

For the Fiscal Year ending September 30, 2003

	Systems Engineering	Business and Technology Services	Corporate	Total
Revenues	$ 50,398	$ 90,642	$ -	$ 141,040
Operating expenses	43,351	86,482	1,573	131,406
Amortization	686	530		1,216
Earnings before interest and income taxes	6,361	3,630	(1,573)	8,418
Interest income				364
Income taxes				3,454
Earnings from continuing operations				5,328
Discontinued operation				480
Net earnings				$ 4,848
Total assets other than cash	$ 15,685	$ 23,097	$ 100	$ 38,882
Cash				25,185
Total assets				$ 64,067
Capital asset expenditures	$ 765	$ 279	$ -	$ 1,044

For the Fiscal Year ending September 30, 2002

	Systems Engineering	Business and Technology Services	Corporate	Total
Revenues	$ 46,373	$ 85,503	$ -	$ 131,876
Operating expenses	40,678	82,491	1,539	124,708
Amortization	754	1,055	-	1,809
Earnings before interest and income taxes	4,941	1,957	(1,539)	5,359
Interest income				202
Income taxes				2,142
Net earnings				$ 3,419
Total assets other than cash	$ 21,028	$ 24,311	$ 200	$ 45,539
Cash				9,488
Total assets				$ 55,027
Capital asset expenditures	$ 551	$ 237	$ -	$ 788

Notes to the Consolidated Financial Statements

Years Ended September 30, 2003 and 2002

(dollars in thousands, except per share data)

11. Segmented information (continued)

The Company's revenues from all foreign countries represent approximately 31% in fiscal 2003 and 32% in fiscal 2002. Revenues from external customers are attributed as follows:

	2003	2002
Canada	69%	68%
United States	12%	14%
Europe	19%	18%

Revenues are attributed to foreign countries based on the location of the customer. No significant assets are held outside of Canada.

Revenues from various departments and agencies of the Canadian Federal Government represented 38% (2002, 37%) of the Company's total revenues. Both operating segments conduct business with this major customer.

In 2003, revenue from a certain customer accounted for 21% of the Company's total revenues (2002, 22%), all from the Business and Technology Services segment.

12. Financial Instruments and Risk Management

The Company is exposed to foreign currency fluctuations on its cash balance, accounts receivable, accounts payable and future cash flows related to contracts denominated in a foreign currency. Future cash flows will be realized over the life of the contracts.

The Company uses financial instruments, principally in the form of forward exchange contracts, in its management of foreign currency exposures. These contracts primarily require the Company to purchase or sell certain foreign currencies with or for Canadian dollars at contractual rates. At September 30, 2003, the Company had the following forward foreign exchange contracts:

Type	Amount	Currency	Maturity	Equivalent Cdn. Dollars
SELL	21,525	USD	October 2003	$ 29,478
BUY	6,245	USD	October 2003	$ 8,553
SELL	16,441	EURO	October 2003	$ 25,245
BUY	12,372	EURO	October 2003	$ 18,998
SELL	71	GBP	October 2003	$ 160
BUY	700	GBP	October 2003	$ 1,532

The unrealized gains and losses in the aggregate related to the above items are not significant.

Notes to the Consolidated Financial Statements

Years Ended September 30, 2003 and 2002

(dollars in thousands, except per share data)

12. Financial Instruments and Risk Management (continued)

In addition, the Company is exposed to credit risk from customers. The Company's business is mostly with large corporations and government clients, which minimizes credit risk. The Company also has credit evaluation, approval and monitoring processes intended to mitigate potential credit risks.

13. Pension Plan

The Company sponsors a defined contribution pension plan for its employees. Required contributions have been fully funded to September 30, 2003. For the year ended September 30, 2003, an amount of $496 (2002, $494) was expensed related to this pension plan.

14. Discontinued Operation

During the year, the Company revised its estimate of the provision for future costs relating to the discontinued e-business operation and recorded an additional non-recurring charge related to the leased premises of $750 ($480 after tax).

Corporate Information

Corporate & Business and Technology Services Division Office

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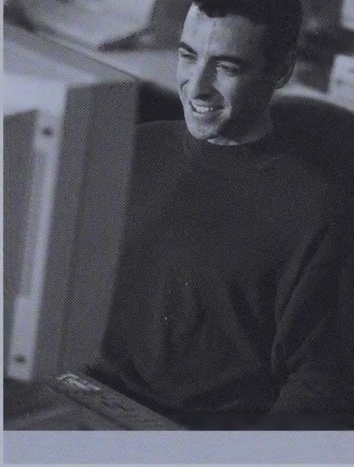

Board of Directors

Larry O'Brien
Chairman and CEO
Calian Technology Ltd.

Anthony F. Griffiths ★ ○
Consultant

William G. Breen ◆
Consultant

Kenneth J. Loeb ◆
President, Capital Box of Ottawa Limited

Major General (retired) C. William Hewson ○
Consultant

Senator David Tkachuk ○

Richard Vickers, FCA ◆
Consultant

★ Lead Director
◆ Member of Audit Committee
○ Member of Compensation and Governance Committee

Common Share Information

The Company's common shares are listed for trading on the Toronto Stock Exchange under the symbol CTY.

Dividend Policy

The Company intends to continue to declare a quarterly dividend of $0.05 per share in line with its overall financial performance and cash flow generation. Decisions on dividend payments are made on a quarterly basis by the Board of Directors. There can be no assurance as to the amount of such dividends in the future.

Annual Meeting of Shareholders

The Annual General Meeting of the shareholders of Calian will be held on January 27, 2004 at 3:00 p.m. at the Brookstreet Hotel, Kanata, Ontario, Canada. All shareholders are invited to attend. The telephone number of the Brookstreet Hotel is 613.271.1800.

Notes

Calian Technology Ltd. Annual Report 2003